

The following transcript was recorded on October 5th, 2026. This transcription is believed to be an accurate summary of the live interview, but may contain some minor differences from the speaker's exact language.

Hi, I'm Akhil Subramanian. I'm one of the portfolio managers here at Pzena Investment Management and we're here to give you a quick recap of the third quarter of 2026. Um after quite a blistering second quarter where the index was up over 20%. Uh the third quarter was a bit more muted. At the end of the day the index finished flat. Um and if you looked under the surface you had sort of the usual dispersion in EM where some countries did well, some countries did not. Um and the same goes for sector. Before sort of diving into the portfolio it was also interesting to see that you know just to remind everybody we are now living in a moment in time where there is quite extreme concentration in the emerging markets index. So for example roughly speaking 40% of the index is the IT sector and almost a third of that is three stocks Taiwan Semiconductor, Samsung, and SK Hynix. So as much as people think about the attractiveness of an asset class like emerging markets where there is access to 20 plus countries each of them going through their own macroeconomic or political cycles plus under the surface companies in different sectors going through their own issues. we're just living in a moment right now where there is quite an extreme level of concentration in EM similar to where the levels were at the end of Q2 but certainly much higher than where they were even looking back a year or maybe even 8 or 9 months ago thinking of December 2025. That concentration is really driven by the excitement and the enthusiasm around the AI capex trade. So companies like TSMC, Samsung, Hynix all have differing exposures to that ultimate AI capex trade and that's where you know investors have been really looking for interesting businesses in EM trying to follow that.

Um the interesting sort of analogy or read through while this is happening is that everything else in EM is sort of doing what it normally does. you know, you have countries that are while very not very represented in the index going through their own issues. For example, Brazil is on the cusp of having elections. Um, that's something that's been going on within India. You're continuing to see a little bit of weakness just in the equity markets and some uncertainty around government policies. And then of course China which is the largest country in the emerging markets by GDP although not by the size when you think about how big China is in the index. Um, China also has its own issues going on in terms of kind of a weak macroeconomic situation, a depressed consumer, some issues in the property market and these are all sort of the negatives and then on the positives also some AI enthusiasm and capex when it comes to some of these Chinese securities that have exposure to things like semiconductors and memory.

Now the interesting thing for us as a value manager is we are not so much focused on the AI capex necessarily and we are looking to the parts of EM where we can find cheap securities cheap relative to how we think about normalized earnings. Normalized earnings being midcycle earnings 5 years out. Um and even in a moment where there is kind of extreme concentration in EM we are looking around, we are finding interesting idiosyncratic company specific opportunities where we can buy good businesses that are suffering from what we believe to be a temporary dislocation in their earnings power.

Now before sort of talking about new names just wanted to touch briefly on some of the contributors and some of the detractors in our portfolio. Um the three largest contributors were

Cognizant, Pacific Basin and Petrobras. Each of them had some sort of positive news over the course of the quarter. Um Cognizant which was our largest contributor as an IT services company. This sector has really been in the crosshairs of the AI disruption. Um but if you look at the fundamentals, you know, Cognizant had a good quarter where they reported positive organic growth, good solid execution of large deals. and a little bit of operating leverage. So I think the market viewed that quite favorably. Uh Pacific Basin is a shipper. So they ship dry bulk and they really benefited from freight rates that have been elevated. For example, given some of the disruption that there's been in the news around the Strait of Hormuz and also the strait on the other side of Saudi Arabia, the Bab al-Mandab Strait. Um and lastly, Petrobras, you know, which is a Brazilian energy company, continued to benefit from elevated energy prices, which have been around since sort of the beginning of the conflict in Iran a couple of months ago.

Looking at the detractors, Samsung, Baidu, and WH Group were our three largest detractors. Um Samsung, which is part of the memory sector, had a very very strong Q2. Some of those companies in there gave back some gains over the course of July. Uh things have stabilized a bit now, but really there was a lot of optimism, enthusiasm, which drove very very strong performance in Q2 and some of these memory semiconductor names gave that back a little bit in the third quarter. Um for us and please feel free to reach out to us. We're happy to discuss this. Um when we think about a company like Samsung which is living through say an earnings upcycle or an earnings boom again we're always looking at what is our long-term earnings power of the business look like the 5-year out normalized earnings and really that's a function of the fundamentals that are driving the sector. So for example, a lot of focus on the incremental supply that's coming online because you know in a shortage situation like memory the natural response is to add supply. Um and on the flip side given the escalating memory prices there is also another natural response which is demand destruction. Um and I'll come to that when I talk about some of the new companies that we were able to buy. Um just touching briefly on some of the other detractors, Baidu had sort of a challenging quarter just given the Chinese macro situation. So the decline in its search business was not offset by the growth in the cloud business. Um but is currently trading at a very attractive valuation and the bulk of its market cap is actually just net cash sitting on the balance sheet. Um and then lastly, WH Group really had a tough quarter where they reported spreads in their US pork business suffering a little bit. Um but at the end of the day it is a very well capitalized business and has has a really really strong Chinese franchise.

Turning to some of the activity in the quarter. So we added two new businesses uh to our emerging markets focused value strategy. Both were in the IT sector and both are sort of viewed as um maybe contra investments or investments that have been suffering because of the enthusiasm around AI. So the first business was Sunny Optical which makes lenses for smartphones and lenses for automotive vehicles and the second company was Chicony Electric uh sorry Chicony Electronics which makes keyboards for laptops and other such personal devices. Now both Sunny and Chicony are good businesses that are operating in industries that have some level of consolidation. They have really good technical capabilities and they have seen market share gains. For example, Sunny Optical is now penetrating the Apple's ecosystem. So getting on to for example the iPhone as a supplier of lenses. Um but both of these companies are suffering at the moment because their end markets are seeing demand destruction, and that demand destruction is really coming from the escalating memory prices that have driven for example the very strong stock performance in Samsung and Hynix. So if you think about the end

markets for Sunny Optical and Chicony um smartphone volumes are being guided down this year, PC volumes are being guided down this year. Uh tablet volumes are being guided down and that's really because if you look at the bill of materials for any of these devices, memory used to be a small component, but the size of that component has increased a lot because memory prices have gone up say 5x year-over-year. So because of that large increase in memory prices, some of the end-market manufacturers, so for example, Apple, Lenovo, Dell, HP are all guiding to volumes being down just because they cannot pass on the surging price of memory to their customers. And so they're faced between this complicated trade-off of increasing price too much and seeing demand go down or not increasing price too much and seeing profitability get hit because of the escalating memory price.

At the end of the day, we believe that both these businesses, Chicony uh and Sunny, are good businesses that will hopefully use this downturn to take some market share and they also have some underappreciated upside to future trends in AI servers. But really the reason we added to them is when we think about normalized earnings five years out um these are good businesses that are facing headwinds to unit volumes um but should be using hopefully this downturn to improve their R&D try to widen that lead versus competitors and also take some share and then you know as you think about some optionality at these two businesses uh Sunny Optical has some great technology around co-packaged optics which could be a future trend in servers where co-packaged optics may replace copper. And for Chicony, they also have um a small business catering to server power delivery and that's also something that could benefit sort of as a new leg to the investment thesis in terms of a new source of revenue growth. So at the end of the day, Sunny and Chicony are good businesses. They're facing a moment of pain with the escalating memory price and we're hopeful that things will normalize. you'll start to see units um stabilizing and then hopefully increasing and that will sort of bring through the normalized earnings power of the business.

In terms of other activity, we added to a couple of businesses um on weakness. For example, Tencent was quite a weak company in the quarter. Um we also trimmed some businesses on strength. For example, OTP, our Hungarian bank. Sort of the usual activity that we are doing here at Pzena when it comes to monitoring our portfolio.

So to summarize, you know, emerging markets um after quite a blistering Q2 were more mixed in the quarter. Um for us, we continue to see quite a lot of concentration kind of at the top end of the index. So concentration in a couple of individual securities. For example, TSMC, which is one business, has a larger index weight than the country of India. Um and outside of TSMC, Samsung and Hynix seeing a lot of concentration in the IT sector. For us at Pzena, we're still able to find IT investments. Interestingly, Sunny and Chicony are more contra than pro AI, but nonetheless have some interesting upside optionality if AI continues to sort of become a dominant theme. But outside of it, just by virtue of the fact that it has become so large, we are seeing a lot of interesting opportunities um in other areas of the market. Geographies that don't have an obvious AI trade or geographies that have idiosyncratic businesses that are facing moments of pain. And so just by the virtue of how concentrated EM is, there are areas of EM that are being overlooked by investors. And we're sticking true to our discipline of going around the world looking for idiosyncratic investment opportunities where good businesses are facing

momentary um you know temporary pain in their earnings. So, we look forward to updating you next quarter um on how things are going in EM and thanks for watching this video.

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